SCPPA

Southern California Public Power Authority

Swap Guidelines

Authorized upon motion carried at the [___date___] meeting of the Board of Directors of the Southern California Public Power Authority. Approved for distribution at the [___date___] Finance Committee meeting.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY

Swap Guidelines

I. INTRODUCTION

The swap guidelines outlined herein are only intended to provide general procedural direction regarding the future use, procurement and execution of interest rate swaps and options. These guidelines are intended to relate to various interest rate hedging techniques, including the contractual exchange of different fixed and variable rate payment streams through interest rate swap agreements. These guidelines are not intended to relate to other derivative products that SCPPA or its members may consider, including but not limited to fuel, currency, power, or energy-related derivatives. The swap policies are not intended in any way to require SCPPA to modify or terminate existing interest rate swaps. SCPPA maintains the right to modify these guidelines and may make exceptions to any of them at any time in its sole discretion. Failure to comply in any manner with these swap guidelines shall not result in any liability on the part of SCPPA to any party.

II. APPROACH AND OBJECTIVES

Interest rate swaps and options are appropriate interest rate management tools that can help SCPPA meet important financial objectives. Properly used, these instruments can increase SCPPA's financial flexibility, provide opportunities for interest rate savings or enhanced investment yields, and help SCPPA manage its balance sheet through better matching of assets and liabilities. Swaps should be integrated into SCPPA's overall debt and investment management guidelines and should not be used for speculation.

Swaps are appropriate to use when they achieve a specific objective consistent with SCPPA's overall financial strategies. Swaps may be used, for example, to lock-in a current market fixed rate or create additional variable rate exposure. Swaps may be used to produce interest rate savings, to alter the pattern of debt service payments, or for asset/liability matching purposes. Swaps may be used to cap, limit or hedge variable rate payments. Options granting the right to commence or cancel an underlying swap may be used to the extent the swap itself is consistent with these guidelines or SCPPA determines there are other advantages to be derived in granting the option; however, SCPPA must determine if the use of any such option is appropriate and warranted given the potential benefit, risks, and objectives of SCPPA. SCPPA's staff, together with its Bond Counsel and its Financial Advisor, periodically shall review SCPPA's swap guidelines and recommend appropriate changes.

In connection with the use of any swaps, SCPPA's Board shall make any finding or findings required by Government Code Section 5922.

Rationales for Utilizing Interest Rate Swaps and Options

1. Optimize capital structure; including schedule of debt service payments and/or fixed vs. variable rate allocations.
2. Achieve appropriate asset/liability match.
3. Reduce risk, including:
   - Interest rate risk;
   - Tax risk; or
   - Liquidity renewal risk.
4. Provide greater financial flexibility.
5. Generate interest rate savings.
6. Enhance investment yields.
7. Manage exposure to changing markets in advance of anticipated bond issuances (through the use of anticipatory hedging instruments).

III. PERMITTED INSTRUMENTS

SCPPA may utilize the following financial products on a current or forward basis, after identifying the objective(s) to be realized and assessing the attendant risks.

1. Interest rate swaps, including fixed, floating and/or basis swaps.
2. Interest rate caps/floors/collars.
3. Options, including swaptions, caps, floors, collars and/or cancellation or index-based features.

The instruments outline above are only intended to relate to various interest rate hedging products. They are not intended to encompass other derivative products that SCPPA or its members may consider, including but not limits to fuel, currency, power or energy-related derivatives.

IV. PROCEDURE FOR SUBMISSION AND EXECUTION

Proposals are to be mailed to the Executive Director, the Accounting Manager and the Financial Advisor for evaluation. Such proposals need to be received by the Executive Director, the Accounting Manager and the Financial Advisor two weeks prior to the next Finance Committee meeting for consideration at such meeting. For proposals received within two weeks of the next Finance Committee meeting, SCPPA reserves the right to consider the proposal at the following month's Finance Committee meeting.

The use of SCPPA's legal counsel in connection with an unsolicited proposal first must be approved by the Executive Director. Legal costs incurred by such use shall be paid by the firm submitting the proposal if the proposal does not close for whatever reason or should SCPPA elect for any reason not to proceed. If SCPPA elects to proceed with the proposed transaction and the proposed transaction closes, SCPPA will absorb such legal costs through costs of issuance.

SCPPA staff and the Financial Advisor shall review all proposals prior to presentation to the Finance Committee. SCPPA shall only present proposals to the Finance Committee that SCPPA, in its sole discretion, believes should be considered further given, for example, the projected savings or other benefits and the ability to meet one or more of the objectives outlined herein. Only proposals that meet the Finance Committee's savings guidelines (as described in the "Guidelines for Financing and Selection of the Financing Team") or that SCPPA staff find compelling for other reasons, shall be presented. A summary of all proposals, including any proposals which will not be submitted in detail, shall be submitted to the Finance Committee on a monthly basis.

Procurement and Execution

SCPPA will not have a fixed guideline with respect to swap procurement. SCPPA will assess the benefits of competitively bidding financial products that are non-proprietary or generally available in the marketplace. On a product-by-product basis, SCPPA will have the authority to negotiate the procurement of financial instruments that have customized or specific attributes designed on SCPPA's behalf.

The Finance Committee may recommend the use of financial derivative products if they meet one of the benefits outlined herein or if they:

1. Provide a specific benefit not otherwise available;
2. Produce greater expected interest rate savings or incremental yield than cash market alternatives;
3. Are not speculative or do not create unreasonable leverage or risk;
4. Result in an improved capital structure or better asset/liability match; or
5. Reasonably pass the risk evaluation required by these guidelines.

Counter-Party Risk Assessment

SCPPA will only do business with highly rated counter parties or counter parties whose obligations are supported by highly rated parties. SCPPA will structure swap agreements to protect itself from credit deterioration of counter parties, including the use of credit support annexes or other forms of credit enhancement to secure counter party performance. Such protection shall include any terms and conditions which in SCPPA's sole discretion are necessary or appropriate or in SCPPA's best interest.

SCPPA shall enter into interest rate swap transactions only with qualified swap counter parties. Qualified swap counter parties are investment banks as will be identified by the Finance Committee and may not necessarily be from SCPPA's underwriting pool. Qualified swap counter parties should be rated at least "Aa3" or "AA-", or equivalent by any two of the nationally recognized rating agencies (i.e. Moody's, Standard and Poor's, and Fitch) or have, as support for their obligations, a "AAA" subsidiary or other entity (e.g. bond insurer) as rated by at least one nationally recognized rating agency. In addition, the counter party must have a demonstrated record of successfully executing swap transactions as well as creating and implementing innovative ideas in the swap market. Each counter party shall have minimum capitalization of at least $150 million.

SCPPA should not have an immutable credit standard. However, SCPPA will attempt to do business with highly rated counter parties of "Aa3" or "AA-" or better. For lower rated (below "Aa3" or "AA-") counter parties, SCPPA should seek credit enhancement in the form of:

1. Contingent credit support or enhancement; or
2. Collateral consistent with the policies contained herein.

Such enhancement needs to raise the counter party's credit quality to the level of qualified swap counter parties.

V. Swap Analysis and Participant Requirements

In connection with any swap, SCPPA and its Financial Advisor shall review the proposed transaction and outline any considerations associated with the transaction to the Finance Committee and the Project participants. Such a review should include the following:

1. The identification of the proposed benefit and potential risks, which shall include, but not necessarily be limited to, those risks outlined herein.
2. Independent analysis of potential savings from a proposed transaction, on a Project and per participant basis.
3. Fixed versus variable rate and swap exposure on a Project and per participant basis before and after the proposed transaction.
4. Market Net Termination Exposure[1] (as outlined herein) on a Project and per participant basis for all existing and proposed transactions at SCPPA.
5. The Finance Committee will consider, to the extent it deems relevant, any rating reports or criteria regarding interest rate swaps by rating agencies.

Prior to seeking Board approval of a proposed swap transaction, SCPPA shall invite to a Finance Committee meeting all participants in the Project subject to the proposed swap transaction to express their views as to whether to recommend the proposed swap transaction to the Board for its consideration. If at such meeting any participant objects in recommending such swap transaction to the Board, then the swap proposal shall not be taken to the Board for its consideration until such time (if ever) as all Project participants are comfortable recommending the transaction for Board consideration.

Swap Risks

1. Counter party Risk – The risk of a payment default on a swap by an issuer's Counter party.
2. Termination Risk - The risk that a swap has a negative value and the issuer owes a "breakage" fee if the contract has to be liquidated.
3. Tax Risk – A mismatch between changes in the rate or price on an issuer's underlying bonds and the swap caused by a reduction or elimination in the benefits of the tax exemption for municipal bonds, e.g. a tax cut, that results in an increase in the ratio of tax-exempt to taxable yields.
4. Basis Risk – A mismatch between the rate on an issuer's underlying bonds and the rate paid under the swap, e.g. a tax-exempt variable rate issue which trades at 62% of LIBOR while the issuer only receives 60% of LIBOR under the swap.
5. Tax Exemption Risk – The risk that the transaction may make the issuer's related bonds taxable.
6. Liquidity/Remarketing Risk – The risk that an issuer cannot secure a cost-effective renewal of a Letter or Line of Credit or suffers a failed auction or remarketing with respect to its variable-rate bonds.

[1] Calculation of termination values for existing SCPPA swaps will be as of the last quarterly valuation date.

Benefit Expectation

Financial transactions, using fixed rate swaps or other derivative products, should generate 2% greater projected savings than the savings guidelines (as described in the "Guidelines for Financing and Selection of the Financing Team") then in effect for traditional bonds. This threshold will serve as a guideline and will not apply should the transaction, in SCPPA's sole judgment, help to meet any of the objectives outlined herein. The higher savings target reflects the greater complexity and higher risk of derivative financial instruments.

For example, assuming a refunding of $100 million of existing bonds, a traditional fixed rate advance refunding that does not use derivative products would have a present value savings threshold of $5.0 million, which is 5.0% of the refunded par. If the refunding structure utilizes a derivative product, the threshold would be $7.0 million in present value savings, 7.0% of the refunded par. Therefore, the transaction utilizing a swap or other derivative product would have to generate an additional $2.0 million to meet the target.

For variable rate or other swap transactions that do not result in a fixed interest rate, SCPPA will evaluate any additional value generated through the transaction in assessing the benefits of proceeding, including the ability to meet the objectives outlined herein. These benefits include, for example, reducing interest rate or tax risk, optimizing the capital structure or further reducing interest expense.

In determining any benefit in implementing a fixed-to-variable swap, the cost of remarketing, in addition to the cost of credit enhancement or liquidity fees must be added to the projected variable rate. Such a calculation should consider the trading performance of comparable bonds and any trading premium resulting from a specific form of credit enhancement or liquidity and/or any impact related to broader industry trends.

VI. Legal and Contractual Requirements

Unless otherwise approved by the Finance Committee, SCPPA will use standard ISDA swap documentation including the Schedule to the Master Agreement and a Credit Support Annex. SCPPA may use additional documentation if the product is proprietary or SCPPA deems in its sole discretion that such documentation is otherwise in its interest.

Terms and Notional Amount of Swap Agreement

SCPPA shall determine the appropriate term for an interest rate swap agreement on a case-by-case basis. In connection with the issuance or carrying of bonds, the term of the swap agreement between SCPPA and a qualified swap counter party shall not extend beyond the final maturity date of existing debt of SCPPA on the related Project, or in the case of a refunding transaction, beyond the final maturity of the refunding bonds. For purposes of calculating net exposure, credit shall be given to any fixed versus variable rate swaps that offset termination exposure for a specific Project or bond transaction. For variable rate transactions, credit may also be given for any assets that are used to hedge a transaction as long as in SCPPA's judgment such assets are reasonably expected to remain in place on a coterminous basis with the swap.

Terms and conditions of any swap shall be negotiated by SCPPA in the best interests of SCPPA subject to the provisions of the Government Code and, unless otherwise waived or altered by SCPPA, these guidelines. The swaps between SCPPA and each counter party shall include, as appropriate, payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as SCPPA, in consultation with its Bond Counsel and Financial Advisor, deems necessary or desirable.

Subject to the provisions contained herein, SCPPA swap documentation and terms should include the following:

1. Downgrade provisions triggering termination shall in no event be worse than those affecting the counter party.
2. Governing law for swaps will be New York law, but should reflect California authorization provisions.
3. The specified indebtedness related to credit events in any swap agreement should be narrowly drafted and refer only to specific Project debt and in no case provide recourse to the members, except as specifically provided under any contracts between potential swap providers and SCPPA's members.
4. Collateral thresholds should be set on a sliding scale reflective of credit ratings (see Collateral below).
5. Eligible collateral as set forth in the Collateral section below.
6. Termination value should be set by "market quotation" methodology, when SCPPA deems appropriate.
7. SCPPA should only agree to an Additional Termination Event for SCPPA to the extent that the ratings on the applicable SCPPA bonds fall below a ratings trigger acceptable to SCPPA and the counter party and no form of credit support or enhancement is in place.

Termination Provision

All swap transactions shall contain provisions granting SCPPA the right to optionally terminate a swap agreement at any time over the term of the agreement. Such a provision shall be required even if any termination is at market. In general, exercising the right to terminate an agreement should produce a benefit to SCPPA, either through the receipt of a payment from a termination or, if the termination payment is made by SCPPA, in conjunction with a conversion to a more beneficial (desirable) debt obligation of SCPPA, as determined by SCPPA.

Collateral

As part of any swap agreement, SCPPA shall require collateralization or other forms of credit enhancements to secure any or all swap payment obligations. As appropriate, SCPPA, in consultation with its Bond Counsel and Financial Advisor, may require collateral or other credit enhancement to be posted by each swap counter party under the following circumstances:

1. Each counter party to SCPPA may be required to post collateral if the credit rating of the counter party or parent falls below the "AAA" category. Additional collateral for further decreases in credit ratings of each counter party shall be posted by each counter party in accordance with the provisions contained in the collateral support agreement to each counter party with SCPPA. Maximum uncollateralized

exposure for: i) "AAA" rated counter parties is $40 million; ii) "AA" rated counter parties is $10 million; and iii) below "AA" category, uncollateralized exposure is zero.

2. Threshold amounts shall be determined by SCPPA on a case-by-case basis. SCPPA will determine the reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter.
3. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between SCPPA and the counter party.
4. A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counter party. A complete list of acceptable securities and valuation percentages are included as Attachment A.
5. The market value of the collateral shall be determined on at least a monthly basis, or more frequently if SCPPA determines it is in SCPPA's best interest given the specific collateral security.
6. The Finance Committee shall determine on a case-by-case basis whether other forms of credit enhancement are more beneficial to SCPPA.

VII. Limitations on Termination Exposure

In order to diversify SCPPA's counter party credit risk, and to limit SCPPA's credit exposure to any one counter party, limits will be established for each counter party based upon both the credit rating of the counter party as well as the relative level of risk associated with each existing and projected swap transaction. The guidelines below provide general termination exposure guidelines with respect to whether SCPPA should enter into an additional transaction with an existing counter party. The SCPPA Board may make exceptions to the guidelines at any time to the extent that the execution of a swap achieves one or many of the goals outlined in these guidelines or provides other benefits to SCPPA.

Such guidelines will also not mandate or otherwise force automatic termination by SCPPA or the counter party. Maximum Net Termination Exposure is not intended to impose retroactively any terms and conditions on existing transactions. Such provisions will only act as guidelines in making a determination as to whether or not a proposed transaction should be executed given certain levels of existing and projected net termination exposure to a specific counter party. Additionally, the guidelines below are not intended to require retroactively additional collateral posting for existing transactions. Collateral posting guidelines are described in the "Collateral" section above. The calculation of net termination exposure per counter party will take into consideration multiple transactions, some of which may offset the overall exposure to SCPPA.

Maximum Net Termination Exposure will be based on the sum of (i) the market value of existing transactions as of the first day of the month prior to the execution of any new transaction plus (ii) the expected worse case termination value of the new transaction. The maximum termination exposure will also be tied to the credit rating of a counter party and whether or not the counter party has posted collateral against this exposure.

Under this approach, SCPPA will set limits on individual counter party exposure based on existing as well as new or proposed transactions. For existing transactions, exposure will be based on the market value as of the last quarterly swap valuation report provided by the Financial Advisor. For a new or proposed transaction, SCPPA will calculate the projected maximum exposure based on the estimated maximum exposure assuming two standard deviations. Standard deviation is a statistic obtained by squaring the average difference from the mean of a distribution of numbers. Two standard deviations capture 95% of the population of a distribution of numbers. For purposes of the calculation, two standard deviations shall be calculated as the annualized standard deviation of weekly swap rates over the preceding 52 weeks. The time period may vary according to market conditions which could range from flat to volatile.

The sum of the existing market value and the projected maximum exposure shall constitute the Maximum Net Termination Exposure. For purposes of this calculation, SCPPA shall include all existing and projected transactions of an individual counter party and all transactions will be analyzed in aggregate such that the maximum exposure will be additive and netted on a per Project basis. The rationale behind aggregating and netting on a Project basis is that the exposure will vary for individual members depending on their participation in different Projects.

For example, SCPPA currently has approximately ($13.0 million) (i.e. SCPPA would owe termination payment) of exposure to UBS AG through the existing floating-to-fixed swap on the STS Series 2001 Bonds. The Maximum Net Termination Exposure on any proposed transaction (with UBS AG as counter party) could not exceed $23 million based on the exposure thresholds below.

The exposure thresholds, which will be reviewed periodically by the Finance Committee to ensure that they remain appropriate, will also be tied to credit ratings of the counter parties and whether or not collateral has been posted. If collateral has been posted, SCPPA could not exceed $30.0 million of collateralized exposure. In addition, there would be a further limit on the amount of uncollateralized exposure, including any threshold amounts under the Credit Support Annex. For AAA-rated counter parties, SCPPA could have up to $40.0 million of uncollateralized exposure; for counter parties in the AA category, SCPPA could have up to $10.0 million of uncollateralized exposure and for counter parties below the AA category, SCPPA could have no uncollateralized exposure. If a counter party has more than one rating, the lowest rating will govern for purposes of the calculating the level of exposure. A summary table is provided below.

Credit Ratings	Maximum Collateralized Exposure	Maximum Uncollateralized Exposure	Maximum Total Termination Exposure
AAA	NA	$40.0 million	$40.0 million
AA Category	$30.0 million	$10.0 million	$40.0 million
Below AA	$30.0 million	None	$30.0 million

Assuming the same example as above, since UBS AG is currently rated "Aa2" and "AA+," the exposure thresholds would only take effect if Net Termination Exposure increased an additional $3.0 million (from the original $7.0 million above).

If the exposure limit is exceeded by a counter party, SCPPA shall conduct a review of the exposure limit per counter party. SCPPA, in consultation with its Bond Counsel and Financial Advisor, shall explore remedial strategies to mitigate this exposure.

VIII. Ongoing Management

SCPPA will seek to maximize the benefits and minimize the risks it carries by actively managing its swap program. This will entail frequent monitoring of market conditions, by both the Financial Advisor and swap counter party, for emergent opportunities and risks. Active management may require modifications of existing positions including, for example:

1. Early termination;
2. Shortening or lengthening the term;
3. Sale or purchase of options; or
4. Use of basis swaps.

IX. Ongoing Reporting Requirements

A written report providing the status of all interest rate swap agreements entered into by SCPPA will be provided to the Finance Committee at least on a quarterly basis (or other basis, if so directed by the Finance Committee) and shall include the following:

1. A description of all outstanding interest rate swap agreements, including Project and bonds series, type of swap, rates paid and received by SCPPA, total notional amount, average life of each swap agreement, remaining term of each swap agreement.
2. Highlights of all material changes to swap agreements or new swap agreements entered into by SCPPA since the last report.
3. Termination Exposure of each of SCPPA's interest rate swap agreements.
4. The credit rating of each swap counter party and credit enhancer insuring swap payments, if any.
5. If applicable, information concerning any default by a swap counter party to SCPPA, including but not limited to the financial impact to SCPPA, if any.
6. If applicable, information concerning any default by a SCPPA to a swap counter party.
7. A summary of swap agreements that were terminated or that have expired.
8. For a swap transaction entered into to generate debt service savings, SCPPA will calculate on an annual basis the actual debt service requirements versus the projected debt service on the swap transaction at the original time of execution. Such a calculation shall include a determination of the cumulative actual savings (or, if applicable, additional payments made by SCPPA) versus the projected savings at the time the swap was executed.

Southern California Public Power Authority

Attachment A – Acceptable Collateral

Security	Valuation Percentage
(A) Cash	100%
(B) (x) Negotiable debt obligations issued by the U.S. Treasury Department or the Government National Mortgage Association ("Ginnie Mae"), or (y) mortgage backed securities issued by Ginnie Mae (but with respect to either (x) or (y) excluding interest only or principal only stripped securities, securities representing residual interests in mortgage pools, or securities that are not listed on a national securities exchange or regularly quoted in a national quotation service) and in each case having a remaining maturity of:	
(i) less than one year	98%
(ii) greater than one year	95%
(C) (x) Negotiable debt obligations issued by the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the Federal Home Loan Mortgage Association ("Fannie Mae") or (y) mortgage backed securities issued by Freddie Mac or Fannie Mae but excluding interest only or principal only stripped securities, securities representing residual interests in mortgage pools, or securities that are not listed on a national securities exchange or regularly quoted in a national quotation service.	95%
(D) Any other collateral acceptable to the SCPPA in it sole discretion.	The valuation percentage shall be determined by the Valuation Agent from time to time and in its reasonable discretion.

For example, if a counter party is required to post $1.0 million of collateral and wished to use Ginnie Mae's with five years remaining to maturity, it would be required to post $1,052,632 ($1.0 million/0.95) to satisfy the collateral requirement.